not increase substantially in the near future or that other materially adverse terms will not be added to our programming contracts.

MARKETING

Our marketing programs and campaigns are based upon a variety of cable services creatively packaged and tailored to appeal to our different markets and segments within each market. We routinely survey our customer base to ensure that we are meeting the demand of promotional campaigns and staying abreast of our competition in order to counter competitors' promotional campaigns effectively. We use a coordinated array of marketing techniques to attract and retain customers and to increase premium service penetration, including door-to-door and direct mail solicitation, telemarketing, media advertising, local promotional events typically sponsored by programming services and cross-channel promotion of new services and pay-per-view.

CUSTOMER RATES

Monthly customer rates for services vary from market to market. Subscribers generally are charged monthly fees based on the level of cable service selected. The monthly prices for various levels of services (excluding services offered on a per-channel or transactional per-program basis) range generally from $15.95 to $25.95 for basic services and from $29.95 to $41.95 for expanded basic services.

We also provide premium television services to our cable subscribers for an additional monthly charge. Such services (including HBO, Showtime and other entertainment networks) are currently sold at a median price of $10.95 per premium when purchased as an a la carte item. Various discounts and promotions are offered to customers who wish to purchase a combination premium package.

Customers who upgrade to our digital packages are offered monthly services for $39.95 to $69.95. Digital packages include standard basic and premium programming, digital music, pay-per-view access, an interactive program guide, as well as a broader menu of both broadcast cable and premium offerings. The digital packages are designed to provide greater flexibility to meet our customer needs.

In limited areas, we offer high speed Internet access to residential customers for $49.90 per month. In addition, we also offer to commercial customers in these markets various internet access options.

A one-time installation fee, which we may wholly or partially waive during a promotional period, is usually charged to new customers. We charge monthly fees for converters and remote control tuning devices. In addition, we also charge administrative fees for delinquent payments for service. Customers are free to discontinue service at any time without additional charge but may be charged a reconnection fee to resume service. Commercial customers, such as hotels, motels and hospitals, are charged a negotiated, non-recurring fee for installation of service and monthly fees. Multiple dwelling unit accounts may be offered a bulk rate in exchange of single-point billing and basic service to all units.

In addition to customer fees, we derive modest revenues from the sale of local spot advertising time on locally originated and satellite-delivered programming. We also derive modest revenues from affiliations with home shopping services, which offer merchandise for sale to customers and compensate system operators with a percentage of their sales receipts.

We also derive revenue from the sale of programming featuring movies and special events to customers on a pay-per-view basis. We believe that we will be able to further increase our pay-per-view penetration rates and revenue as we continue to deploy addressable technology in upgraded systems and in systems where we launch digital service.

While we plan to offer advanced telecommunications services in certain of our cable systems, we anticipate that monthly customer fees derived from multi-channel video services will continue to constitute the large majority of our total revenues for the foreseeable future.

GENERAL DEVELOPMENTS

BANKRUPTCY PROCEEDINGS

On November 13, 2001, we and all of our wholly owned subsidiaries filed voluntary petitions for reorganization under chapter 11 of title 11 of the United States Code in the United States Bankruptcy Court for the District of Delaware (the "Court"). We and each of our debtor subsidiaries continue to manage our businesses as a debtor-in-possession. The Chapter 11 cases are being jointly administered under Case No. 01-11257. The Chapter 11 cases are discussed in greater detail in the Notes to the Consolidated Financial Statements. As debtors-in-possession, management is generally authorized to operate the businesses, but may not engage in certain transactions, including those outside the ordinary course of business, unless approved by the Court. After the Chapter 11 filings, we obtained several Court orders authorizing the payment of certain pre-petition liabilities (such as certain employee wages and benefits and programming fees) and taking certain actions designed to preserve the going concern value of the business and thereby enhance the reorganization prospects.

Under bankruptcy law, absent a court order, actions by creditors to collect certain pre-petition indebtedness owed by us at the filing date are stayed and certain other pre-petition contractual obligations may not be enforced against us. In addition, we have the right, subject to Court approval and other conditions, to assume or reject any pre-petition executory contracts and unexpired leases. Parties affected by these rejections may file claims with the Court. The amounts of claims filed by creditors could be significantly different from the amounts we have recorded. Due to material uncertainties, it is not possible to predict the length of time we will operate under Chapter 11 protection, the outcome of the proceedings in general, whether we will continue to operate under our current organizational structure, the effect of the proceedings on our businesses or the recovery by our creditors and equity holders.

A final order of the Court approved a $30 million secured super-priority debtor-in-possession revolving credit agreement ("DIP Financing") for our sole direct subsidiary, Classic Cable, Inc. ("Cable"), with Goldman Sachs Credit Partners L.P. ("Goldman Sachs") as administrative agent, lead arranger and syndication agent. We, along with all of our subsidiaries, guaranteed Cable's obligations under the DIP Financing and have pledged our assets in connection with such guarantee. As of December 31, 2001, we were not in compliance with certain covenants contained therein. See the section "Debt Agreements" below for further discussion.

Pursuant to the Bankruptcy Code, we have filed schedules with the Court setting forth our assets and liabilities as of the date of the filing. Differences between amounts recorded by us and claims filed by creditors will be investigated and resolved as part of the proceedings in the Chapter 11 cases.

The bar date for filing certain proofs of claim against us is March 29, 2002 (May 13, 2002 for governmental entities). Accordingly, the ultimate number and allowed amount of such claims are not presently known.

BRECKENRIDGE SALE

In October 2001, we, through certain subsidiaries, sold assets associated with the Breckenridge, Colorado cable system to TCI Cable Partners of St. Louis, L.P. for approximately $16.3 million, subject to working capital adjustments. We expect to receive the final payment in the second quarter of 2002. We don't estimate receiving more than $1.5 million. This amount is subject to change. On October 24, 2001, our 1999 credit facility was amended to permit the Breckenridge disposition.

RESTRUCTURING

In the fourth quarter of 2000, we initiated a plan to streamline our field operations and to consolidate all of our corporate and administrative functions at our Tyler, Texas office. This plan included the closing of the Plainville, Kansas call center (move to Tyler completed April 2001) and the Austin, Texas corporate office (move completed to Tyler February 2001). In conjunction with the plan, we accrued and charged to corporate overhead in the fourth quarter of 2000 $1.1 million of termination benefits relating to approximately 200 employees. The affected employees were primarily in administrative functions in office locations that were closed during 2001, including Plainville and Austin. In addition, certain levels of operations management were eliminated. All amounts were paid out in 2001 to 163 employees. Other costs related to our restructuring efforts incurred during 2001 were $655,000.

STAR ACQUISITION

In February 2000, an indirect wholly owned subsidiary purchased substantially all of the assets of Star Cable Associates ("Star"), which operates cable television systems in Texas, Louisiana and Ohio, for an aggregate purchase price of approximately $111 million in cash and 555,555 shares of Class A Voting Common Stock ("Class A Common Stock").

DEBT AGREEMENTS

In November 2001, Cable borrowed $2.0 million on its $30 million DIP Financing. As of December 31, 2001, we were not in compliance with certain financial and other covenants specified in our DIP Financing and our 1999 credit facility. We are prohibited from drawing any more funds on the DIP Facility until we either cure the defaults or the lenders agree to waive such defaults. We are currently in negotiations on an amendment and waiver to the DIP Financing to cure such covenant violations. There are no guarantees that the negotiations will be successful or if they are that we will be able to comply with the covenants.

Cable failed to make an aggregate $7.2 million of interest payments due on its 9.375% senior subordinated notes and its 9.875% senior subordinated notes that were due on August 1, 2001. In addition, Cable failed to make the $11.8 million interest payment on its 10.5% senior subordinated notes that was due on September 4, 2001. The failure of Cable to make the interest payments is an event of default under the Indentures under which the notes were issued.

As a result of the bankruptcy filing, all available commitments of the 1999 credit facility were cancelled.

In February 2001, Cable borrowed an additional $19.5 million on its revolver.

In February 2000 Cable issued $225 million of 10.5% senior subordinated notes due 2010. Interest payments on these notes began in September 2000. The proceeds of the offering were used to fund a portion of the acquisition of the assets of Star, repay a portion of indebtedness under Cable's senior credit facility and repurchase approximately $36 million of Cable's 9.875% senior subordinated notes due 2008.

The senior subordinated notes are unsecured and are subordinated to all existing and future senior indebtedness of Cable. The notes rank without preference with all existing and future senior subordinated indebtedness of Cable. The senior subordinated notes may be redeemed contingent on certain events and/or the passage of time at the redemption price, which may include a premium. Restrictive covenants associated with these notes limit our ability to enter into certain transactions.

In January 2000, we redeemed all outstanding 13.25% senior discount notes at a redemption price equal to 113.25% of the accreted value of the notes. This resulted in an extraordinary loss of $13.3 million ($9.3 million, net of taxes).

The 1999 credit facility was amended in February 2000 and September 2000 to (a) allow for the Star acquisition, (b) allow for certain transactions related to Cable's tower portfolio, and (c) modify some of the financial covenants in the credit facility. The amendment of the 1999 credit facility resulted in an extraordinary loss of $8.5 million ($5.5 million, net of taxes).

The amendments to the 1999 credit facility also increased the applicable margins associated with the facility's interest calculations as well as the range of potential quarterly commitment fees. The quarterly commitment fees can range from 0.375% to 0.750% per annum on the unused loan commitments.

See Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources for further information.

INITIAL PUBLIC OFFERING

In December 1999, we completed an initial public offering of 7,250,000 shares of our Class A Common Stock. Some of our stockholders sold an additional 2,237,500 shares. We raised approximately $168.9 million of net proceeds in the offering. We used the net proceeds from the offering to pay offering expenses, to redeem all of our outstanding 13.25% senior discount notes and to finance part of the Star acquisition.

THE BUFORD ACQUISITION

In July 1999, Cable acquired Buford Group, Inc., which operates cable television systems in Arkansas, Louisiana, Missouri and Texas, for approximately $300 million in cash. The Buford cable systems added approximately 170,000 basic subscribers and, we believe, represented an excellent geographic and strategic fit with our other cable systems. In addition, we believe that the Buford acquisition provided other benefits, including an opportunity to reduce programming costs, consolidate headends and enhance customer service. The Buford acquisition was financed through a $350 million credit facility and the issuance of $150 million of Cable's senior subordinated notes due 2009.

THE BRERA CLASSIC EQUITY INVESTMENT

In connection with the Buford acquisition, we received $100 million from Brera Classic, LLC, $3.3 million of which was paid to Brera Classic pursuant to management and advisory fee agreements, and $750,000 of which was paid to Brera Classic to reimburse Brera Classic for certain of its fees and expenses incurred in connection with the Brera Classic equity investment. This equity investment was financed through the sale of common stock to Brera Classic.

TECHNICAL OVERVIEW

We endeavor to maintain high technical performance standards in all of our cable systems. To accomplish this, we continue to invest capital to upgrade our cable systems selectively. This investment will (a) expand channel capacities, (b) enhance signal quality, (c) improve technical reliability, and (d) provide a platform to develop high-speed data services and Internet access. Before committing the capital to upgrade or rebuild a system, we carefully assess:

o the existing technical reliability and picture quality of the system;

o basic subscribers' demand for more channels;

o requirements in connection with franchise renewals;

o programming alternatives offered by our competitors;

o customers' demand for other cable television and broadband telecommunications services; and

o the return on investment of any such capital outlay.

We own or lease approximately 670 towers that are used to receive off-air broadcast signals from the nearest urban transmit site or via intermittent microwave relay stations. Our towers range from 10 feet to 600 feet in height and approximately 150 of our towers are at least 200 feet in height. We lease tower space to cellular telephone, personal communications services paging and other transmission companies for a fixed monthly charge typically dictated by long-term contract.

FRANCHISES

Cable television systems are typically constructed and operated under non-exclusive franchises granted by local governmental authorities. These franchises typically contain conditions, such as:

o time limitations on commencement and completion of construction;

o conditions of service, including number of channels, types of programming and the provision of free service to schools and certain other public institutions; and

o the maintenance of insurance and indemnity bonds.

Certain provisions of local franchises are subject to state regulation as well as federal regulation under the 1984 Cable Act, the 1992 Cable Act and the 1996 Telecommunications Act.

Our franchises, all of which are non-exclusive, generally provide for the payment of fees to the issuing authority. Franchise fees imposed on the cable systems range from 0% to 5% of certain revenues generated by the cable systems. With limited exceptions, franchise fees are passed directly through to the customers on their monthly bills. The 1984 Cable Act prohibits franchising authorities from imposing franchise fees in excess of 5% of gross revenues, and permits a cable operator to seek renegotiation and modification of franchise requirements if warranted by changed circumstances. In some cases, our franchises can be terminated by the franchising authority prior to the stated expiration date for uncured breaches by us of material provisions.

INDUSTRY OVERVIEW

A cable television system receives television, radio and data signals at the system's "headend" site by means of off-air antennas, microwave relay systems and satellite earth stations. These signals are then modulated, amplified and distributed through coaxial and fiber optic distribution systems to deliver a wide variety of channels of television programming to subscribers who pay fees on a monthly basis for this service. A cable television system may also originate its own television programming and other information services for distribution through its system. Cable television systems generally are constructed and operated pursuant to non-exclusive franchises or similar licenses granted by local governmental authorities for a specified period of time.

The cable television industry developed in the United States in the late 1940's and early 1950's in response to the needs of residents in predominantly rural and mountainous areas of the country where the quality of off-air television reception was inadequate due to factors such as unfavorable topography and remoteness from television broadcast towers. In the 1960's, cable systems also developed in non-metropolitan markets that had limited availability of off-air television station signals. All of these markets are regarded within the cable industry as "classic cable" television system markets.

Cable television systems offer customers programming consisting of broadcast television signals of local network affiliates, independent and educational television stations, a limited number of television signals from so-called "super stations" originating from distant cites, such as WGN from Chicago, various channels, such as Cable News Network, Music Television, the USA Network, Turner Network Television, and Entertainment and Sports Programming Network, programming originated locally by the cable television system, such as public, government and education access programs, and informational displays featuring news, weather and public service announcements. For an additional monthly charge, cable television systems also offer "premium" television services to customers on a per-channel basis. These services, such as Home Box Office, Cinemax, Showtime, The Movie Channel and selected regional sports networks, are channels that consist principally of feature films, live sporting events, concerts and other special entertainment features, usually presented without commercial interruption.

A customer generally pays an initial installation charge and a fixed monthly fee for basic and premium television services and for other services, such as the rental of converters and remote control devices. These monthly service fees constitute the primary source of revenues for cable television systems. In addition to customer revenues from these services, cable television systems generate revenues from additional fees paid by customers for pay-per-view programming of movies and special events and from the sale of available advertising spots on advertiser-supported programming. Cable television systems also frequently offer their customers home shopping services for a share of the revenues from products sold in their service areas. The cable television industry is changing rapidly due to new technology and new alliances between cable television and other telecommunications companies. Providing traditional cable television programming is only one aspect of the industry as potential opportunities to expand into Internet, broadband data, telephone, and other telecommunications services continue to develop and become more commercially viable.

COMPETITION

Cable television systems face competition from (a) alternative methods of receiving and distributing television signals, such as off-air television broadcast programming, direct broadcast satellite services, known as "DBS," and wireless cable services, and (b) other sources of news, information and entertainment, such as newspapers, movie theaters, live sporting events, on-line computer services and home video products. Our competitive position depends, in part, upon reasonable prices to customers, greater variety of programming and other communications services, and superior technical performance and customer service. Accordingly, cable operators in rural areas, where off-air reception is more limited, generally achieve higher penetration rates than cable operators in major metropolitan areas, where numerous, high quality off-air signals are available.

Cable television systems generally operate pursuant to franchises granted on a nonexclusive basis, so that more than one cable television system may be built in the same area, known as an "overbuild," with potential loss of revenue to the operator of the original system. It is possible that a franchising authority might grant a second franchise to another company containing terms and conditions more favorable than those afforded to us. The 1992 Cable Act prohibits franchising authorities from unreasonably denying requests for additional franchises and permits franchising authorities to operate cable television systems without a franchise. Although a private competitor ordinarily would seek a franchise from a local jurisdiction, municipalities have built and operated their own systems. Overbuilds historically have been relatively rare, as constructing and developing a cable television system is capital-intensive, and it is difficult for the new operator to gain a marketing advantage over the incumbent operator. We currently have 17 systems in an overbuild situation passing approximately 17,389 homes.

In recent years, the FCC and Congress have adopted policies providing a more favorable operating environment for new and existing technologies that provide, or have the potential to provide, substantial competition to cable television systems. These technologies include, among others, DBS service, whereby signals are transmitted by satellite to satellite dishes as small as 18 inches located on customer premises. Programming is currently available to the owners of DBS dishes through conventional, medium and high-powered satellites. DBS systems provide movies, broadcast stations, and other program services comparable to those of cable television systems. DBS systems can also provide high speed Internet access. DBS service can be received anywhere in the continental United States through installation of a small rooftop or side- mounted antenna. This technology has the capability of providing more than 100 channels of programming over a single high-powered satellite with significantly higher capacity if multiple satellites are placed in the same orbital position. DBS is currently being heavily marketed on a nationwide basis by two DBS providers. DBS providers are significant competition to cable service providers, including us.

The 1992 Cable Act contains provisions, which the FCC has implemented with regulations, to enhance the ability of cable competitors to purchase and make available to home satellite dish owners certain satellite delivered cable programming at competitive costs. The FCC also adopted regulations that preempt certain local restrictions on satellite and over-the-air antenna reception of video programming services, including zoning, land-use or building regulations, or any private covenant, homeowners' association rule or similar restriction on property within the exclusive use or control of the antenna user. Digital satellite service, known as DSS, offered by DBS systems has certain advantages over traditional analog cable systems with respect to programming and digital quality, as well as disadvantages that include high up-front costs and a lack of local service and equipment distribution. Our strategy of providing pay-per-view and perhaps satellite niche programming via digital services in certain of our cable systems is designed to combat digital satellite service competition. "Bundling" of our video service with advanced telecommunications services in certain of the cable systems may also be an effective tool for competing with DSS. DBS suffers certain significant operating disadvantages compared to cable television, however, including line-of-sight reception requirements and up-front costs associated with the dish antenna and equipment. Legislation removing legal obstacles to retransmitting local broadcast programming to DBS subscribers was signed into law by President Clinton on November 29, 1999. This eliminated a significant competitive advantage which cable system operators have had over direct broadcast satellite operators. Direct broadcast satellite operators deliver local broadcast signals in many markets which we serve. These companies and others are also developing ways to bring advanced communications services to their customers. They are currently offering satellite-delivered high-speed Internet access services with a telephone return path and are beginning to provide true two-way interactivity.

Cable television systems also compete with wireless program distribution services such as multichannel multipoint distribution service, or MMDS, which use low power microwave signals to transmit video programming and high speed data services, including Internet access, over the air to customers. Additionally, the FCC licensed new frequencies in the 28 MHz band for a new multichannel wireless video service similar to MMDS, known as Local Multipoint Distribution Service, or LMDS. LMDS is also suited for providing wireless data services, including the possibility of Internet access. Wireless distribution services generally provide many of the programming services provided by cable systems, and digital compression technology may significantly increase the channel capacity of these wireless distribution services. Because MMDS service requires unobstructed "line of sight" transmission paths, the ability of MMDS systems to compete may be hampered in some areas by physical terrain and foliage.

Federal cross-ownership restrictions historically limited entry by local telephone companies into the cable television business. The 1996 Telecom Act eliminated this cross-ownership restriction, making it possible for companies with considerable resources to overbuild existing cable systems. Congress has also repealed the prohibition against national television networks owning cable systems. Various local exchange carriers, commonly referred to as LECs, currently are providing video programming services to some locations within their telephone service areas through a variety of distribution methods, primarily through the deployment of broadband wire facilities, but also through the use of wireless or MMDS transmission. A number of telephone companies have obtained cable television franchises from local governmental authorities and provide cable television services. Cable television systems could be placed at a competitive disadvantage if the delivery of video programming services by LECs becomes widespread, since LECs may not be required, under certain circumstances, to obtain local franchises to deliver such video services or to comply with the variety of obligations imposed upon cable television systems under such franchises. The entry of telephone companies as direct competitors is likely to continue and could adversely affect the profitability and valuation of our cable systems. Issues of cross-subsidization by LECs of video and telephony services also pose strategic disadvantages for cable operators seeking to compete with LECs that provide video services. We believe, however, that the non-metropolitan markets in which we provide or expect to provide cable services are unlikely to support such competition from LECs in the provision of video and telecommunications broadband services given the lower population densities and higher costs per subscriber of installing a plant.

The entry of electric utility companies into the cable television business, as now authorized by the 1996 Telecom Act, could also have an adverse effect on our business. Well-capitalized businesses from outside the cable industry may also become competitors for franchises or providers of competing services.

Other new technologies may become competitive with non-entertainment services offered by cable television systems. The FCC has authorized television broadcast stations to transmit textual and graphic information useful both to consumers and businesses. The FCC also permits commercial and noncommercial FM stations to use their sub-carrier frequencies to provide non-broadcast services including data transmissions. The FCC has established an over-the-air Interactive Video and Data Service that will permit two-way interaction with commercial and educational programming along with informational and data services. The expansion of fiber optic systems and the introduction of new xDSL services by LECs and other common carriers provide facilities for the transmission and distribution to homes and businesses of video services, including interactive computer-based services like the Internet, data and other non-video services. Wireless Internet access is now offered in many markets by cellular, PCS and other mobile service providers, such as Nextel.

Advances in communications technology as well as changes in the marketplace and the regulatory and legislative environments are constantly occurring. Thus, it is not possible to predict the effect that ongoing or future developments might have on the cable industry or on our operations.

EMPLOYEES

At December 31, 2001, Classic had approximately 885 employees. None of our employees are represented by a labor union. We consider our relations with our employees to be good.

LEGISLATION AND REGULATION

The operation of cable television systems is extensively regulated by the FCC, some state governments and most local governments. The 1996 Telecom Act altered the regulatory structure governing the nation's telecommunications providers. It removes barriers to competition in both the cable television market and the local telephone market. Among other things, it reduces the scope of cable rate regulation.

The 1996 Telecom Act required the FCC to implement numerous rulemakings, some of which are still subject to court challenges. Moreover, Congress and the FCC have frequently revisited the subject of cable television regulation and may do so again. Future legislative and regulatory changes could adversely affect our operations. This section briefly summarizes certain of the key laws and regulations currently affecting the growth and operation of our cable systems.

CABLE RATE REGULATION

The 1992 Cable Act imposed an extensive rate regulation regime on the cable television industry, which limited the ability of cable companies to increase subscriber fees. Under that regime, all cable systems were subjected to rate regulation, unless they faced "effective competition" in their local franchise area. Federal law now defines "effective competition" on a community-specific basis as requiring satisfaction of conditions not typically satisfied in the current marketplace.

Although the FCC establishes all cable rate rules, local government units (commonly referred to as local franchising authorities or "LFAs") are primarily responsible for administering the regulation of the lowest level of cable - the basic service tier ("BST"), which typically contains local broadcast stations and public, educational, and government, or PEG access channels. Before an LFA begins BST rate regulation, it must certify to the FCC that it will follow applicable federal rules, and many LFAs have voluntarily declined to exercise this authority. LFAs also have primary responsibility for regulating cable equipment rates. Under federal law, charges for various types of cable equipment must be unbundled from each other and from monthly charges for programming services, and priced no higher than the operator's actual cost, plus an 11.25% rate of return.

The FCC historically administered rate regulation of any cable programming service tiers ("CPST"), which typically contain satellite-delivered programming. Under the 1996 Telecom Act, however, the FCC's authority to regulate CPST rates sunset on March 31, 1999. The FCC has taken the position that it will still adjudicate pending CPST complaints but will strictly limit its review, and possible refund orders, to the time period predating the sunset date.

CABLE ENTRY INTO TELECOMMUNICATIONS

Cable entry into telecommunications will be affected by the regulatory landscape now being fashioned by the FCC and state regulators. The 1996 Telecom Act provides that no state or local laws or regulations may prohibit or have the effect of prohibiting any entity from providing any interstate or intrastate telecommunications service. States are authorized, however, to impose "competitively neutral" requirements regarding universal service, public safety and welfare, service quality, and consumer protection. State and local governments also retain their authority to manage the public rights-of-way. Although the 1996 Telecom Act clarifies that traditional cable franchise fees may be based only on revenues related to the provision of cable television services, it also provides that LFAs may require reasonable, competitively neutral compensation for management of the public rights-of-way when cable operators provide telecommunications service. There have been several conflicting and inconclusive federal court decisions that addressed the issues of lawful "management of the right-of-ways" and "competitively neutral compensation," but some doubt remains. The 1996 Telecom Act prohibits LFAs from requiring cable operators to provide telecommunications service or facilities as a condition of a franchise grant, renewal or transfer, except that LFAs argue they can seek "institutional networks" as part of such franchise negotiations. The favorable pole attachment rates afforded cable operators under federal law can be increased by utility companies owning the poles during a five-year phase-in period beginning in 2001 if the cable operator provides telecommunications service, as well as cable service, over its plant. Although recent decisions of the United States Supreme Court and the FCC have clarified that a cable operator's provision of Internet service does not affect the favorable pole attachment rates, we anticipate that utility companies will continue to press for higher pole rates.

CABLE SYSTEMS PROVIDING INTERNET SERVICE

Although there is at present no significant federal regulation of cable system delivery of Internet services the FCC recently issued reports finding no immediate need to impose such regulation but requesting comment on various regulatory possibilities. Increased regulation may occur as cable systems expand their broadband delivery of Internet services. In particular, proposals have been advanced at the FCC and Congress that would require cable operators to provide nondiscriminating access to unaffiliated Internet service providers and online service providers. The Federal Trade Commission and the FCC imposed certain open access requirements on Time Warner and AOL in connection with their merger, but those requirements are not applicable to other cable operations. Additionally, some local franchising authorities have imposed mandatory Internet access requirements on cable operators, although there are conflicting court decisions regarding the legality of such actions. Numerous other franchise authorities are considering imposing similar requirements, either during transfer or renewal processes or by promulgating regulations pursuant to their general franchise authority. Finally, several states are considering legislation that would require mandatory access for unaffiliated Internet service providers. Some large cable systems have committed to provide such access in the future. These developments could, if they become widespread, burden the capacity of cable systems and complicate and delay plans for providing Internet service.

TELEPHONE COMPANY ENTRY INTO CABLE TELEVISION

The 1996 Telecom Act allows telephone companies to compete directly with cable operators both inside and outside their telephone service areas. Because of their resources, LECs could be formidable competitors to traditional cable operators, and certain LECs have begun offering cable service. We currently have telephone overbuilds in six systems passing approximately 5,180 homes.

Under the 1996 Telecom Act, an LEC or other entity providing video programming to customers will be regulated as a traditional cable operator (subject to local franchising and federal regulatory requirements), unless it elects to provide its programming via an "open video system" ("OVS"). A January 1999 federal court of appeals decision held that OVS providers can be required to obtain a local franchise. To be eligible for OVS status, the provider cannot occupy more than one-third of the system's activated channels when demand for channels exceeds supply. Nor can it discriminate among programmers or establish unreasonable rates, terms or conditions for service.

Although LECs and cable operators can now expand their offerings across traditional service boundaries, the general prohibitions remain on LEC buyouts (i.e., any ownership interest exceeding 10 percent) of co-located cable systems, cable operator buyouts of co-located LEC systems, and joint ventures among cable operators and LECs in the same market. The 1996 Telecom Act provides a few limited exceptions to this buyout prohibition, including certain rural areas.

ELECTRIC UTILITY ENTRY INTO TELECOMMUNICATIONS/CABLE TELEVISION

The 1996 Telecom Act provides that registered utility holding companies and subsidiaries may provide telecommunications services, cable television services, information services and other services or products subject to the jurisdiction of the FCC notwithstanding the Public Utilities Holding Company Act. Electric utilities must establish separate subsidiaries, known as "exempt telecommunications companies" and must apply to the FCC for operating authority. Again, because of their resources, electric utilities could be formidable competitors to traditional cable systems.

MUST CARRY/RETRANSMISSION CONSENT

The 1992 Cable Act contains broadcast signal carriage requirements that allow local commercial television broadcast stations to elect once every three years between requiring a cable system to carry the station ("must carry") or negotiating for payments for granting permission to the cable operator to carry the station ("retransmission consent"). Less popular stations typically elect must carry, and more popular stations typically elect retransmission consent. In addition, local non-commercial stations are given must carry rights, and retransmission consent must be obtained to carry "distant" broadcast stations, except for certain "superstations." Must carry requests can dilute the appeal of a cable system's programming offerings, and retransmission consent demands may require substantial payments or other concessions (e.g. a requirement that the cable system also carry the local broadcaster's affiliated cable programming service). Either option has a potentially adverse effect on our business. The burden associated with must-carry obligations could dramatically increase if television broadcast stations proceed with planned conversions to digital transmissions and if the FCC determines that cable systems must carry all analog and digital signals transmitted by the television stations.

ACCESS CHANNELS

LFAs can include franchise provisions requiring cable operators to set aside certain channels for public, educational and government ("PEG") access programming. Federal law also requires a cable system with 36 or more channels to designate a portion of its activated channel capacity (up to 15%) for commercial leased access by unaffiliated third parties. The FCC's rules regulate the terms, conditions and maximum rates a cable operator may charge for use of this designated channel capacity, but use of commercial leased access channels has been relatively limited.

"ANTI-BUY THROUGH" PROVISIONS

Federal law requires each cable system to permit customers to purchase premium or pay-per-view video programming offered by the operator on a per-channel or a per-program basis without the necessity of subscribing to any tier of service (other than the basic service tier) unless the system's lack of addressable converter boxes or other technological limitations does not permit it to do so. The statutory exemption for cable systems that do not have the technological capability to comply expires in October 2002, but the FCC may extend that period.

ACCESS TO PROGRAMMING

To spur the development of independent cable programmers and competition to incumbent cable operators, the 1992 Cable Act imposed restrictions on the dealings between cable operators and cable programmers. In particular satellite video programmers affiliated with cable operators cannot favor cable operators over competing multichannel video programming distributors (such as DBS and MMDS distributors). This provision limits the ability of vertically integrated satellite cable programmers to offer exclusive programming arrangements to cable companies. Both Congress and the FCC have considered proposals that would expand the program access rights of cable's competitors, including the possibility of subjecting both terrestrially delivered video programming and video programmers who are not affiliated with cable operators to all program access requirements.

INSIDE WIRING; SUBSCRIBER ACCESS

The FCC's rules require an incumbent cable operator, upon expiration of a multiple dwelling unit service contract, to sell, abandon, or remove "home run" wiring that was installed by the cable operator in a multiple dwelling unit building. These inside wiring rules are expected to assist building owners in their attempts to replace existing cable operators with new programming providers who are willing to pay the building owner a higher fee, where such a fee is permissible. The FCC has also proposed abrogating all exclusive multiple dwelling unit service agreements held by incumbent operators, but allowing such contracts when held by new entrants. In another proceeding, the FCC has preempted restrictions on the deployment of private antennas on rental property within the exclusive use of a tenant, such as balconies and patios. This FCC ruling may limit the extent to which multiple dwelling unit owners may enforce certain aspects of multiple dwelling unit agreements which otherwise prohibit, for example, placement of digital broadcast satellite receiver antennae in multiple dwelling unit areas under the exclusive occupancy of a renter. These developments may make it more difficult for us to provide service in multiple dwelling unit complexes.

OTHER REGULATIONS OF THE FCC

In addition to the FCC regulations noted above, there are other regulations of the FCC covering such areas as:

- equal employment opportunity (currently stayed as a result of a judicial ruling);
- subscriber privacy;
- programming practices, including, among other things:
    (1) syndicated program exclusivity, which requires a cable system to delete particular programming offered by a distant broadcast signal carried on the system which duplicates the programming for which a local broadcast station has secured exclusive distribution rights;

    (2) network program nonduplication;

    (3) local sports blackouts;

    (4) indecent programming;

    (5) lottery programming;

    (6) political programming;

    (7) sponsorship identification;

    (8) children's programming advertisements; and

    (9) closed captioning;
- registration of cable systems and facilities licensing;
- maintenance of various records and public inspection files;
- aeronautical frequency usage;

- lockbox availability;
- antenna structure notification;
- tower marking and lighting;
- consumer protection and customer service standards;
- technical standards;
- consumer electronics equipment compatibility;
- emergency alert systems;
- pole attachments; and
- franchise transfers.

The FCC regulations require that cable customers must be allowed to purchase cable converters from third parties and established a multi-year phase-in which began July 1, 2000, during which security functions, which would remain in the operator's exclusive control, would be unbundled from basic converter functions, which could then be satisfied by third party vendors.

The FCC has the authority to enforce its regulations through the imposition of substantial fines, the issuance of cease and desist orders and/or the imposition of other administrative sanctions, such as the revocation of FCC licenses needed to operate certain transmission facilities used in connection with cable operations.

COPYRIGHT

Cable television systems are subject to federal copyright licensing covering carriage of television and radio broadcast signals. In exchange for filing certain reports and contributing a percentage of their revenue to a federal copyright royalty pool (such percentage varies depending on the size of the system and the number of distant broadcast television signals carried), cable operators can obtain blanket permission to retransmit copyrighted material on broadcast signals. The possible modification or elimination of this compulsory copyright license is subject to continuing review and could adversely affect our ability to obtain desired broadcast programming. In addition, the cable industry pays music licensing fees to Broadcast Music, Inc. and the American Society of Composers, Authors and Publishers. Copyright clearances for nonbroadcast programming services are arranged through private negotiations.

STATE AND LOCAL REGULATION

Cable television systems generally are operated pursuant to nonexclusive franchises granted by a municipality or other state or local government entity. The 1996 Telecom Act clarified that the need for an entity providing cable services to obtain a local franchise depends solely on whether the entity crosses public rights of way. Federal law now prohibits franchise authorities from granting exclusive franchises or from unreasonably refusing to award additional franchises covering an existing cable system's service area. Cable franchises generally are granted for fixed terms and in many cases are terminable if the franchisee fails to comply with material provisions. Non-compliance by the cable operator with franchise provisions may also result in monetary penalties.

The terms and conditions of franchises vary materially from jurisdiction to jurisdiction. Each franchise generally contains provisions governing cable operations, service rates, franchise fees, system construction and maintenance obligations, system channel capacity, design and technical performance, customer service standards and indemnification protections. A number of states subject cable television systems to the jurisdiction of centralized state governmental agencies. Although LFAs have considerable discretion in establishing franchise terms, there are certain federal limitations. For example, LFAs cannot insist on franchise fees exceeding 5% of the system's gross revenue, cannot dictate the particular technology used by the system, and cannot specify video programming other than identifying broad categories of programming.

Federal law contains renewal procedures designed to protect incumbent franchisees against arbitrary denials of renewal. Even if a franchise is renewed, the franchise authority may seek to impose new and more onerous requirements such as significant upgrades in facilities and services or increased franchise fees and funding for PEG channels as a condition of renewal. Similarly, if a franchise authority's consent is required for the purchase or sale of a cable system or franchise, such authority may attempt to impose more burdensome or onerous franchise requirements in connection with a request for consent. Historically, franchises have been renewed for cable operators that have provided satisfactory services and have complied with the terms of their franchises.